



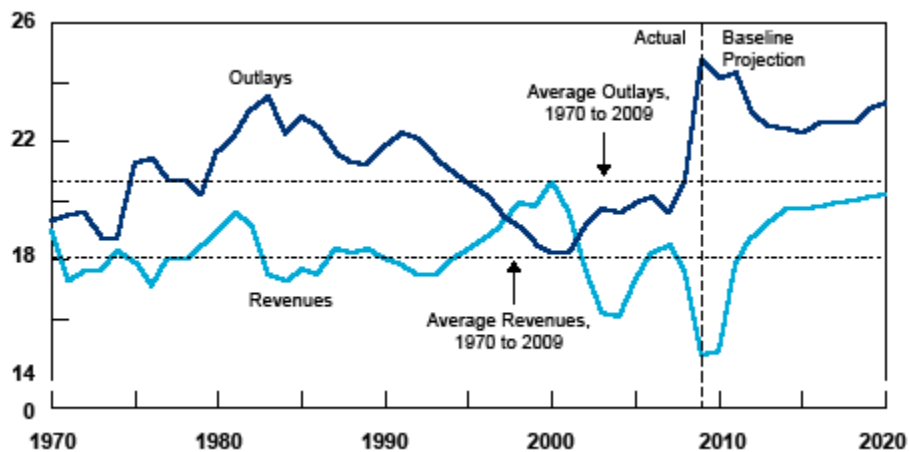
# A Look at the Economic Climate Going Forward

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*TACC Director's Development Program  
Lubbock, TX Feb. 11, 2010*

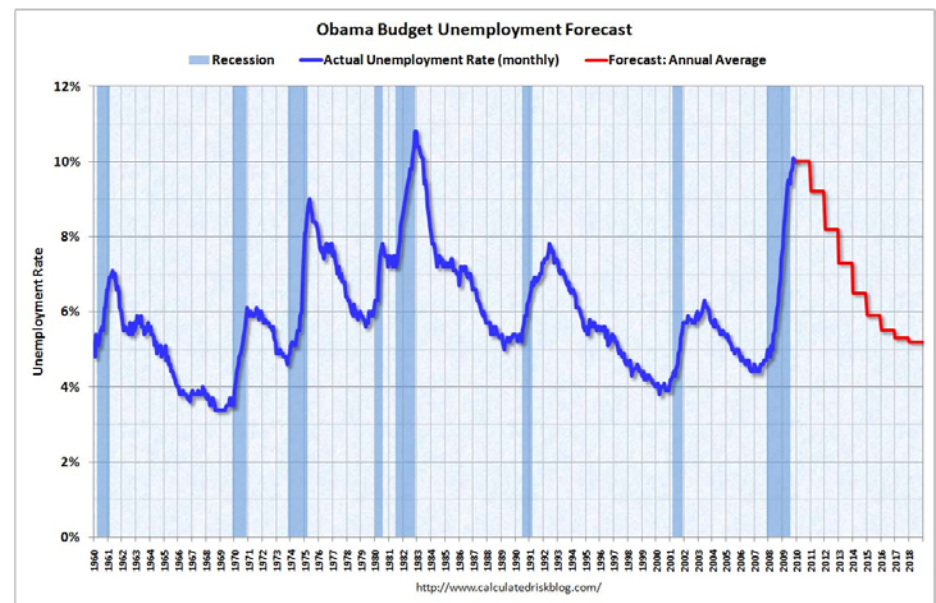
# A budgetary nightmare



- **BASELINE** government outlays will exceed even the peak years of the Cold War spending under Reagan.
- Projected deficits will result in a debt load of 77.2% of GDP by 2020, assuming all of the Administration's projections are met.

# A key assumption

- Unemployment will magically fall below 8% in the next year or so...



# Do deficit's matter?

- **NO**
  - In the short-run (2-5 years), deficits may be necessary to offset unforeseen shocks in aggregate demand—smoothing the bumps
- **YES**
  - They result in higher levels of accumulated debt relative to GDP, which results in higher long-term borrowing costs
    - Higher borrowing cost either comes from inflation (monetizing the debt) or greater competition for scarce money...no such thing as a free lunch
- **Administration Consensus**
  - We saw a \$1.6T drop in aggregate demand due to recession; must replace that in order to retain economic growth
- **My Opinion**
  - The level of spending before the recession was unsustainable and based on inflated real estate prices
  - Some targeted spending would help, but re-inflating the bubble is detrimental to long-term economic health

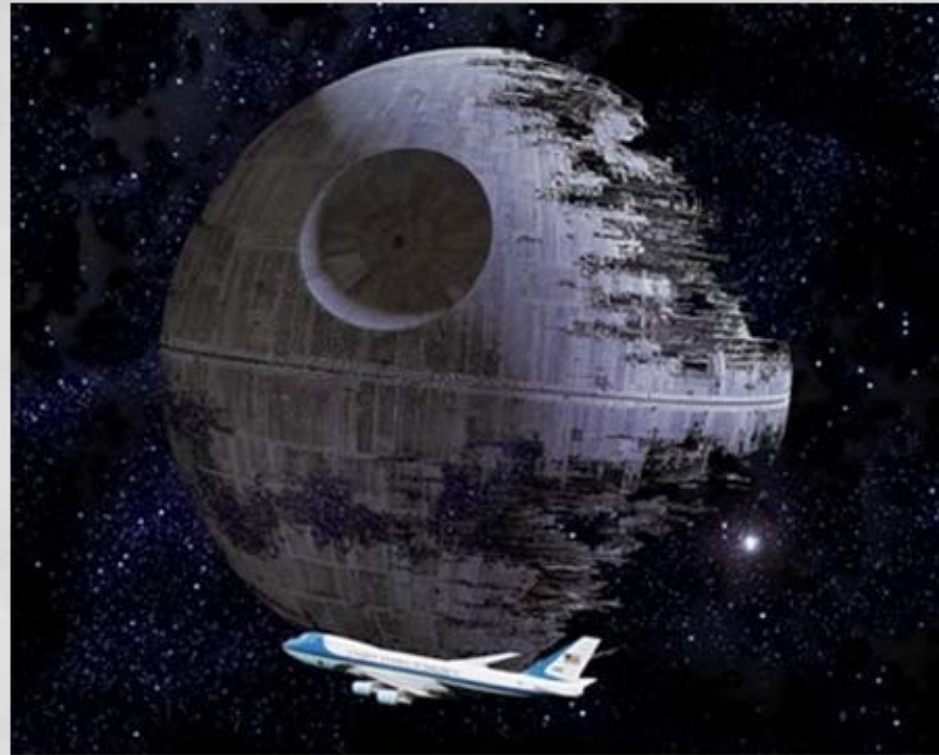
# Latest Bailout Request

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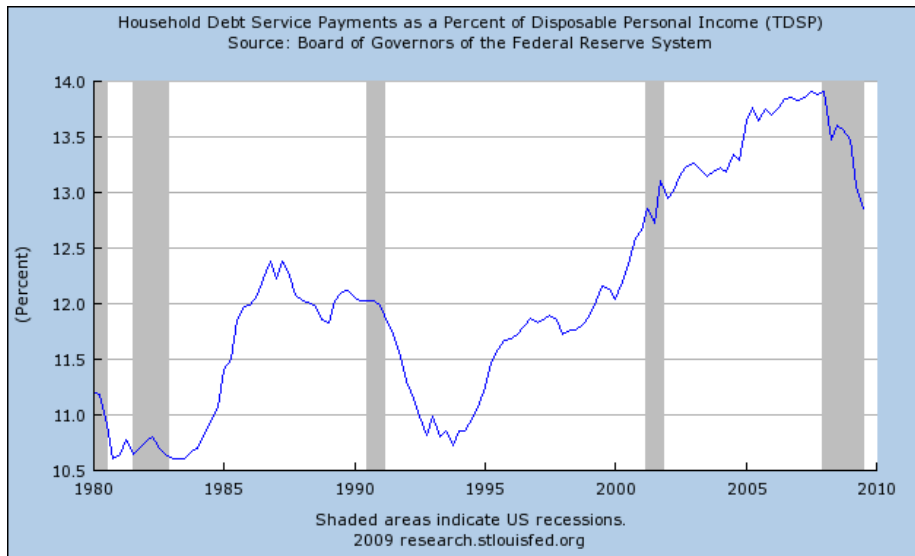
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“Too Big to Fail??”

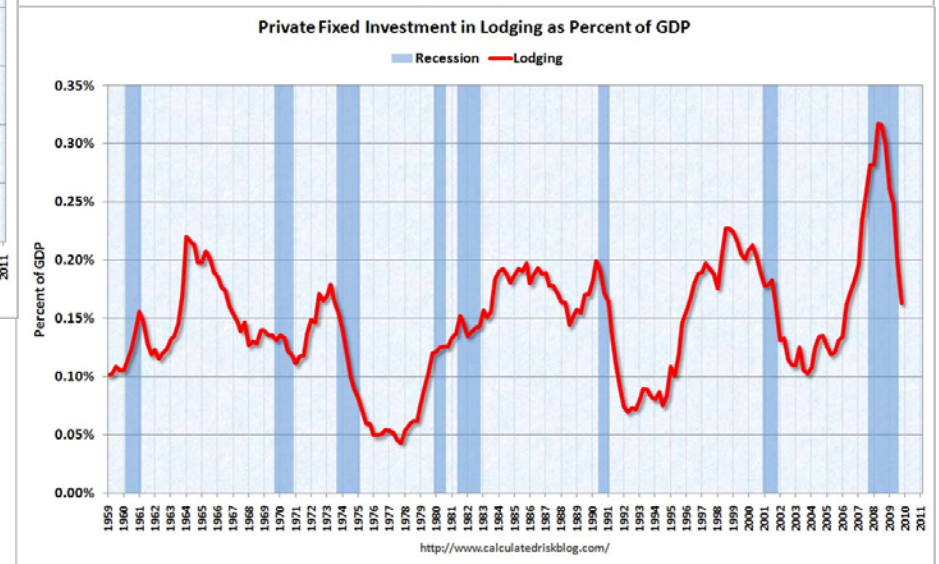
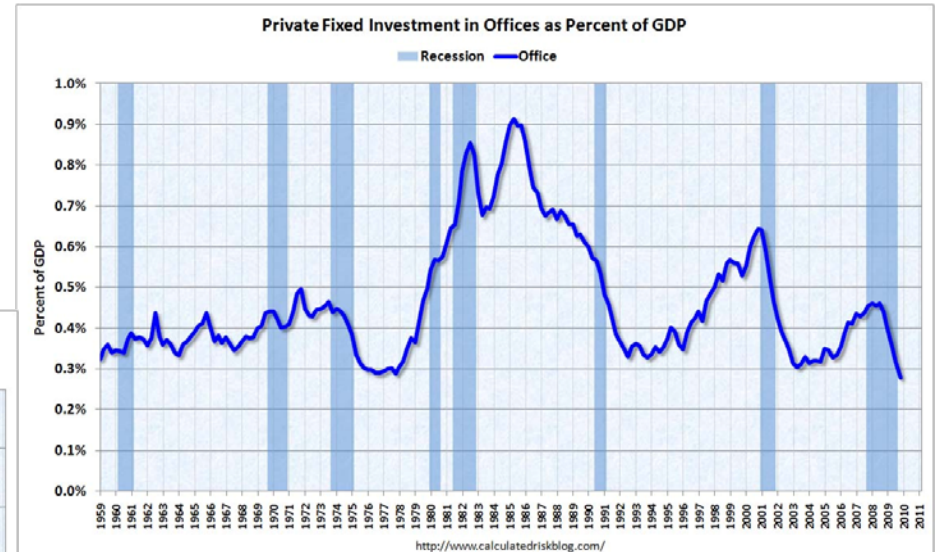
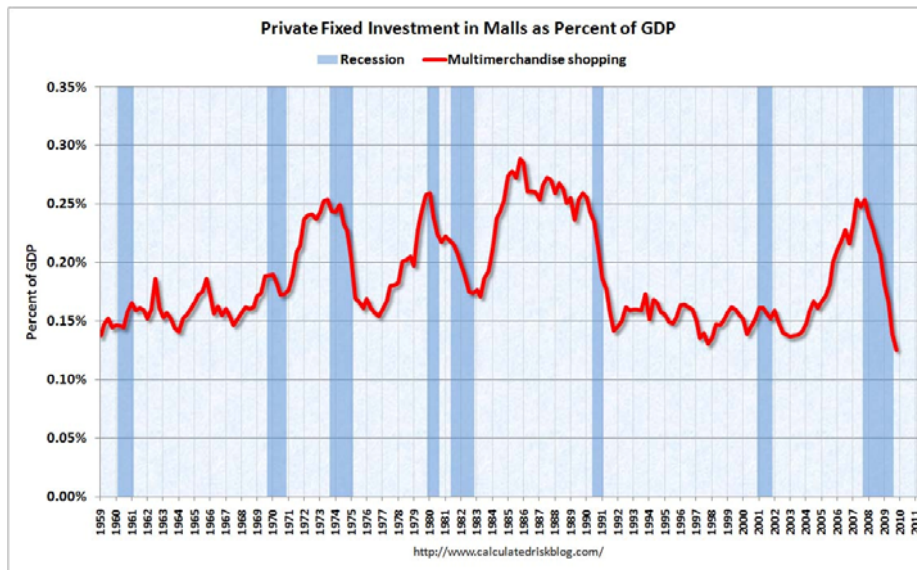
# The American public gets it—and why the additional borrowing may be less harmful than feared



- Private debt service has declined dramatically—savings rate has gone up.
- Despite borrowing more, current borrowing is less (in percentage terms) from foreign sources than before
- **Caveat**—This is at least in part because the Fed is doing more purchasing, masking the effects of excessive borrowing

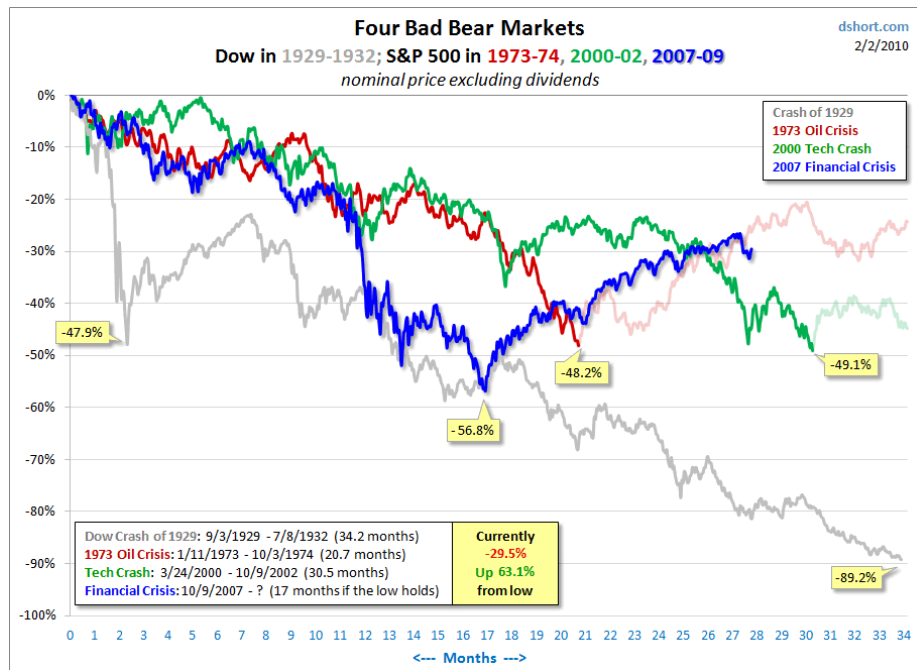


# Other indicators

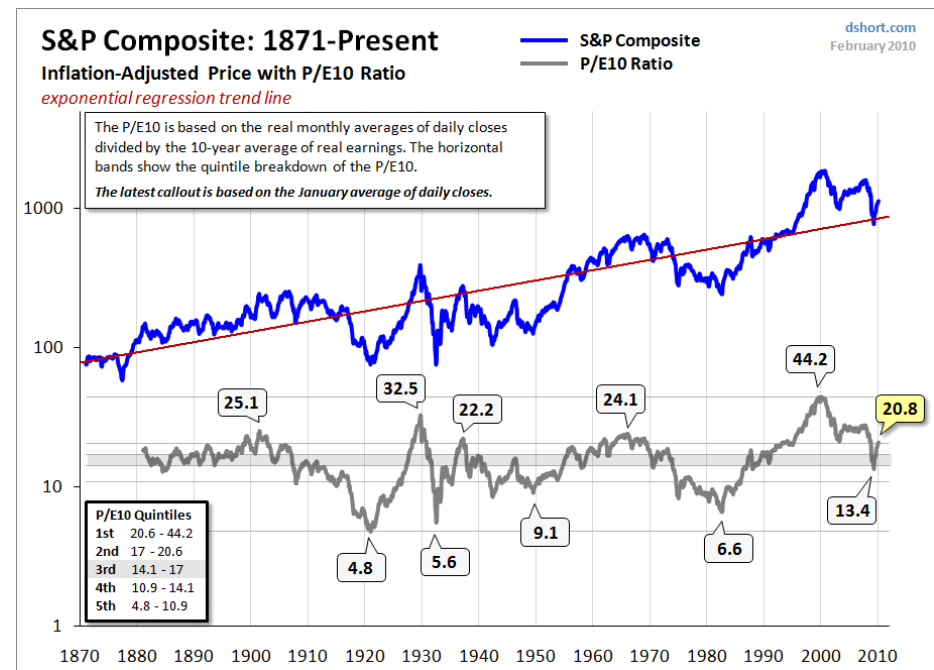


# Other indicators

## Overall Market



## Market Valuation





# Commodity prices

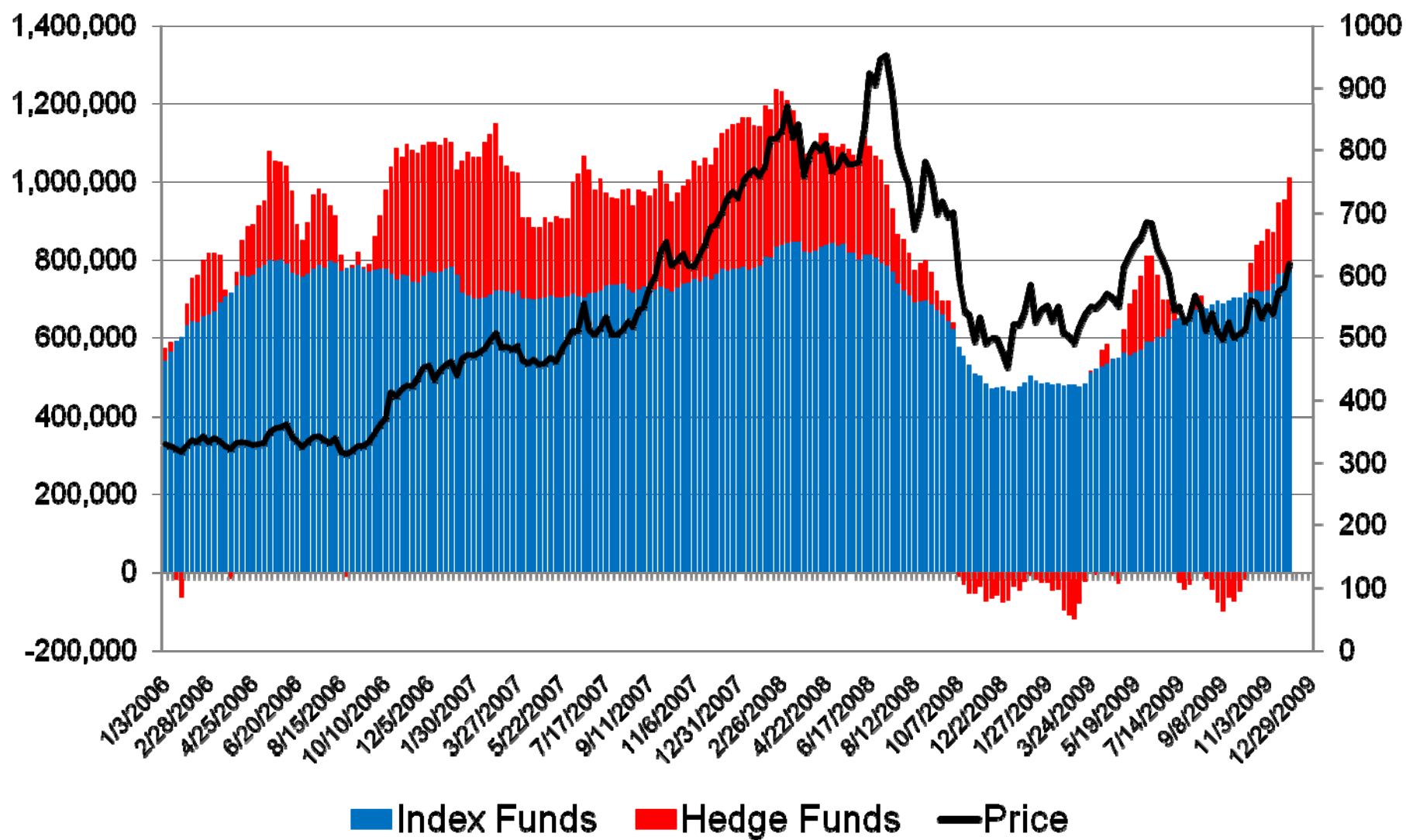
## Corn



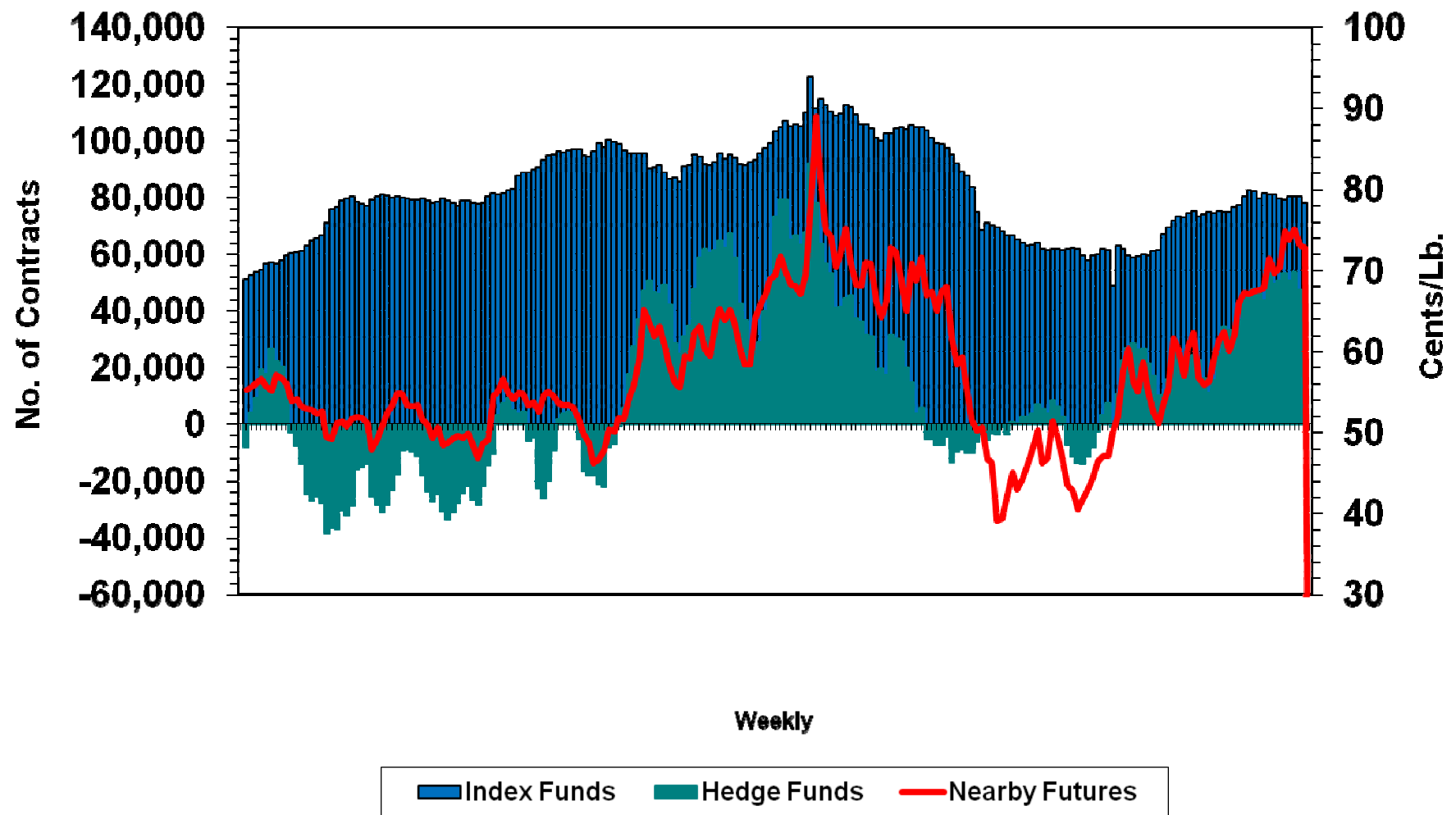
## Cotton



# Grains Prices and Speculators



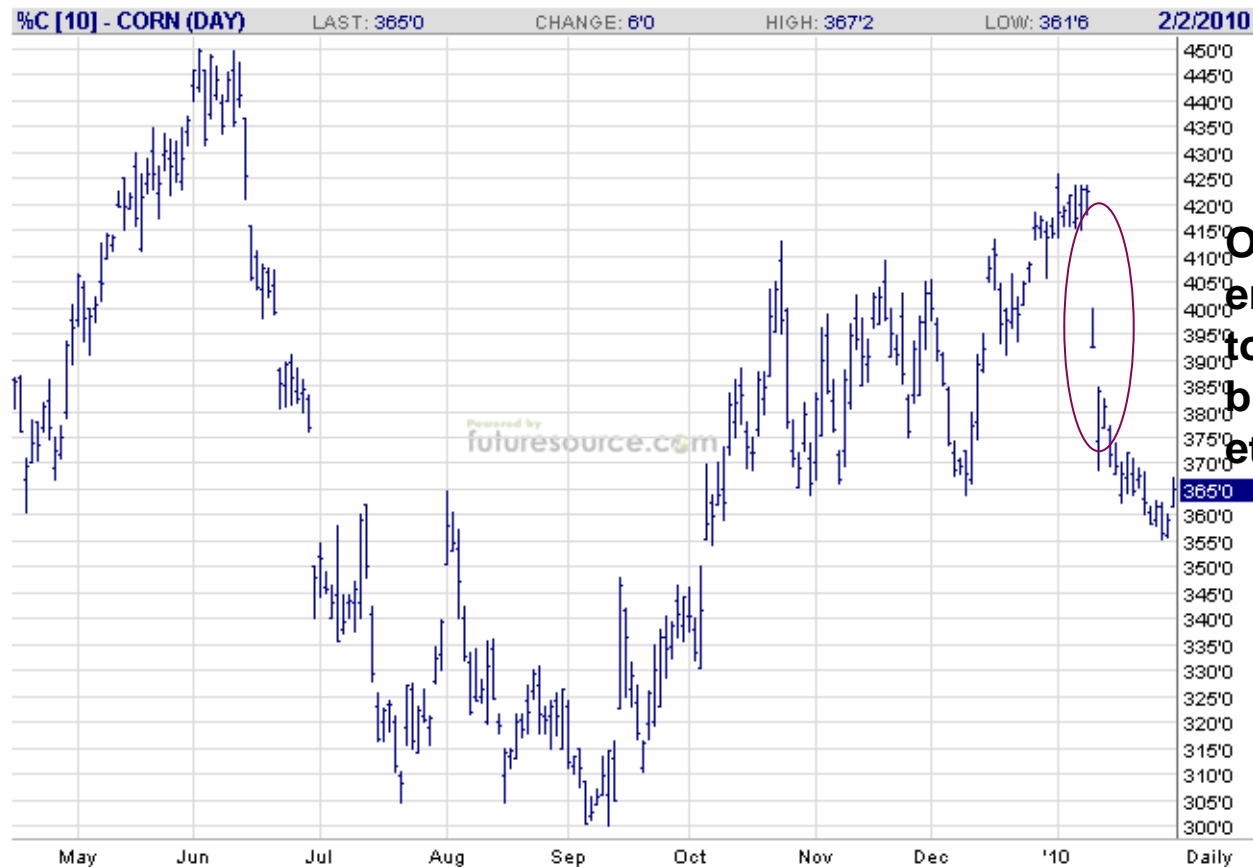
# Cotton Prices and Speculators





## Market Timing

While there appears to be more fundamental “legs” under the most recent rally, hedge funds still are an important player in the market. In fact, little has changed since the last financial crisis in terms of regulation or market operation.



**Obama announces  
emphasis to shift  
to alternative  
biofuels in place of  
ethanol.**

## Policy Impacts

Policy matters—in many ways more immediate impact than supply and demand because it affects the rules of the game, which affects expectations.

# Policy

- President's budget:
  - Reductions in traditional farm program payments
  - Some shift to conservations, but that is minor compared to reductions that have already taken place
  - Increase in USDA funding
    - Most of the increase goes to food assistance and nutrition programs
    - Also major increases in employee compensation, expense accounts for FAS, etc.
- Attitudes towards farm policy changing to some degree
  - Traditional coalitions becoming more fragmented
    - Corn/ethanol working in other arenas, often in competition with other agricultural groups
    - Less representation tied to production agriculture; more representation tied to urban centers; hence the greater emphasis on food assistance and nutrition programs



# Conclusions

- Volatility continues to be the rule, not the exception, in commodity markets.
  - Driven largely by money flows in and out of markets
    - Cannot “overregulate” speculators—need their liquidity in the markets
  - Greatly complicates pricing of crops for farmers/merchants
  - Offers opportunities for those willing to invest the time and energy in monitoring and understanding the markets
- Policy uncertainty is creating volatility as well
  - Who wants to invest or lend when you are uncertain what policy will be from day to day?
  - The associated “risk premium” of being in the market is higher because of the uncertainty
- Agricultural sector looks healthy compared to other parts of the economy
  - BUT, the lack of consumer spending is hurting commodities like cotton more than other crops
    - We are seeing improvement in cotton as a consequence of anticipated economic recovery